

Message Text

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PAGE 01 LIMA 07179 121650Z

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SUBJ: CENTRAL BANK HEAD JUSTIFIES AND EXPLAINS GOVERNMENT
ECONOMIC PROGRAM

1. SUMMARY: ON THE EVENING OF AUGUST 9, DR. MANUEL MOREYRA LOREDO, PRESIDENT OF THE CENTRAL BANK, GAVE A TELEVISED SPEECH EXPLAINING AND JUSTIFYING THE GOVERNMENT'S ECONOMIC AND FINANCIAL POLICIES. THE SPEECH REVEALED LITTLE NEW, BUT WAS AN ATTEMPT TO EXPLAIN THE CAUSES OF THE ECONOMIC CRISIS AND THE POLICIES BEING IMPLEMENTED TO THE AVERAGE PERUVIAN. HE DIVIDED THE ECONOMIC AND FINANCIAL PROGRAM INTO THREE SECTIONS: POLICIES TO INCREASE INVESTMENT, ESPECIALLY THE PART WHICH IS FINANCED INTERNALLY, IN ORDER TO INCREASE PRODUCTION AND EMPLOYMENT; POLICIES TO DECREASE INFLATION; AND POLICIES TO INSURE THE SUPPLY OF EXTERNAL RESOURCES. THROUGHOUT THE SPEECH MOREYRA STRESSED THE NEED FOR SACRIFICE AND THE JUST DISTRIBUTION OF THAT SACRIFICE. THE AUSTERITY PROGRAM WILL BE GRADUAL (TWO AND A HALF YEARS) IN ORDER TO AVOID GREAT ECONOMIC SUFFERING. BUT HE STRESSED THAT IF THE POLICY IS ABANDONED (AS IT WAS IN 1976) AFTER THE INITIAL AND MOST SEVERE MEASURES ARE TAKEN, ALL BENEFITS WILL BE LOST. HE CONCLUDED WITH A STRONG DEFENSE OF THE POLICIES OF FINANCE MINISTER, SILVA RUETE.

UNCLASSIFIED

UNCLASSIFIED

PAGE 02 LIMA 07179 121650Z

2. INVESTMENT POLICIES. MOREYRA EXPLAINED THAT THE PRESENT CRISIS ORIGINATED IN A SLOWDOWN OF INTERNAL SAVINGS AND INVESTMENT COUPLED WITH AN EXCESSIVE INCREASE IN CONSUMPTION. IN ADDITION, THE GOVERNMENT BORROWED LARGE SUMS EXTERNALLY, CHIEFLY TO FUND UNPRODUCTIVE CONSUMPTION. AS A RESULT EXTERNAL BORROWINGS OF THE PUBLIC SECTOR ROSE FROM \$672 MILLION IN 1974 TO \$1.07 BILLION IN 1975.

ALTHOUGH THE FIGURE FELL TO \$797 IN 1976 OWING TO THE AUTOMATIC STABILIZER PROGRAM, ABANDONMENT OF THE POLICY RESULTED IN A FIGURE OF \$1 BILLION FOR 1977. THE MAJOR REASON FOR THESE LARGE INTERNATIONAL BORROWINGS WAS AN ABSURD, RIGID EXCHANGE RATE AND INTEREST RATE POLICY. THE CENTRAL BANK HEAD STRESSED THAT BOTH THE EXCHANGE RATE AND INTEREST RATES HAD TO BE FLEXIBLE IN ORDER TO REFLECT ACTUAL ECONOMIC CONDITIONS. HE JUSTIFIED THE CENTRAL BANK POLICY OF SMALL ADJUSTMENTS IN THE EXCHANGE RATE WHICH TAKE INTO ACCOUNT DOMESTIC INFLATION WITHOUT SEVERELY DISRUPTING THE PRIVATE SECTOR. MOREYRA DEFENDED THE RECENT INCREASE IN INTEREST RATES, WHICH THE PRIVATE SECTOR HAS SEVERELY CRITICIZED. WITHOUT POSITIVE INTEREST RATES, THE FINANCIAL SYSTEM WILL NOT ATTRACT FUNDS FOR INVESTMENT. HIGHER INTEREST RATES WOULD ALSO SLOW THE DEPRECIATION OF THE SOL, THEREBY CUTTING IMPORT COSTS FOR FIRMS. FINALLY, HE STATED THAT NEGATIVE REAL INTEREST RATES CONSTITUTE A HIDDEN SUBSIDY FOR BUSINESS, ENCOURAGING UNPRODUCTIVE BORROWING. THE INITIAL SACRIFICE FOR THE PRIVATE SECTOR FROM INCREASED INTEREST RATES MUST BE BORNE IN ORDER TO ACHIEVE INCREASED PRODUCTION AND EMPLOYMENT IN THE LONG RUN.

3. POLICIES TO REDUCE INFLATION. MOREYRA STATED THAT THE PRINCIPAL CAUSE OF THE RAPID INCREASE IN PRICES IS EXCESSIVE MONEY CREATION BY THE CENTRAL BANK RELATIVE TO REAL PRODUCTION INCREASES. BETWEEN 1974 AND JUNE 1978 PERU'S REAL GROSS DOMESTIC PRODUCT INCREASED 49 0/0 WHEREAS THE MONEY SUPPLY INCREASED 151 0/0. THE GOVERNMENT'S TARGET IS A 50 PERCENT REDUCTION IN THE INFLATION RATE OF 1979 FOLLOWED BY A SIMILAR DECREASE IN 1980. THIS GOAL WILL BE ACHIEVED BY A RADICAL REDUCTION IN CURRENT EXPENDITURES BY THE GOVERNMENT INCLUDING SUBSIDIES, A MAJOR TAX REFORM, AND A REDUCTION IN EXCESSIVE WAGE INCREASES. HE PROMISED THAT AVAILABLE CREDIT WOULD BE CHANNLED INTO THE PRIORITY AREAS OF AGRICULTURE, ENERGY, MINING AND ESports.

UNCLASSIFIED

PAGE 03 LIMA 07179 121650Z

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4. POLICIES TO INSURE SUPPLY OF EXTERNAL RESOURCES. MOREYRA BLAMED SOME OF PERU'S PROBLEMS RELATED TO HIGH EXTERNAL DEBT AND FOREIGN EXCHANGE SCARCITY ON INEQUALITIES INHERENT IN THE PRESENT INTERNATIONAL ECONOMIC SYSTEM BETWEEN DEVELOPED AND DEVELOPING COUNTRIES. HIS SOLUTIONS TO THE PROBLEM, HOWEVER, EMPHASIZED THE INTERNAL EFFORTS OF THE COUNTRY--INCREASED DOMESTIC SAVING, HIGHER EXPORTS, MORE INVESTMENT, AND THE ESTABLISHMENT OF PRODUCTION PRIORITIES. HE CLAIMED THAT THE WORSE OF THE FINANCIAL CRISIS WAS OVER. LONG DELAYS IN MAKING PRIVATE FOREIGN EXCHANGE PAYMENTS HAVE PASSED, ARREARAGES ARE BEING REDUCED RAPIDLY, AND DISTORTIONS IN THE FOREIGN EXCHANGE MARKET ARE MINIMAL.

HOWEVER, HE ADDED THAT PERU'S EXTERNAL DEBT IS LARGE AND THE MATURITY STRUCTURE ONEROUS IN THE NEXT FEW YEARS, MAKING A PARTIAL RESCHEDULING OF DEBT NECESSARY. IN THE FUTURE PERU WILL BORROW LESS EXTERNALLY, FOR LONGER PERIODS OF TIME AND USE THE RESOURCES GAINED FOR INVESTMENT, NOT CONSUMPTION.

5. COMMENT: THE SPEECH WAS AN IMPORTANT REITERATION AND JUSTIFICATION OF THE AUSTERITY PROGRAM. WHETHER IT ACHIEVED THE PURPOSE OF EXPLAINING THE ECONOMIC CRISIS AND PROPOSED SOLUTION TO THE PERUVIAN PUBLIC IS MORE OPEN TO QUESTION. MANY OF THE ISSUES ARE COMPLEX AND INTERRELATED. NEVERTHELESS, THE TALK WAS CLEAR IN EMPHASIZING THE NEED FOR SACRIFICE ON THE PART OF ALL SOCIAL GROUPS IN THE COUNTRY
UNCLASSIFIED

UNCLASSIFIED

PAGE 04 LIMA 07179 121650Z

AND THE IMPORTANCE OF THE PROGRAM'S CONTINUATION THROUGH THE NEXT TWO AND A HALF YEARS. SHLAUDEMAN

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